RISING SUN
MANAGEMENT LTD

1st Quarter 2023 Report to the NAVF Board

Performance of the Fund for 2020, 2021, 2022 and Q1 2023:

	JPY	Sterling/Yen FX Change	GBP	Cumulative JPY	Cumulative FX	Cumulative GBP
21 February 2020 to 31 December 2020	12.19%	1.39%	13.58%	12.19%	1.39%	13.58%
Year Ending 31 December 2021	34.18%	-12.77%	21.41%	50.54%	-12.64%	37.90%
1st Quarter 31 March 2022	-5.01%	-2.28%	-7.30%	42.99%	-15.15%	27.84%
2nd Quarter 30 June 2022	-2.26%	-3.07%	-5.33%	39.76%	-18.73%	21.03%
3rd Quarter 30 September 2022	6.13%	2.24%	8.37%	48.33%	-17.17	31.16%
4th Quarter 31 December 2022	5.19%	1.90%	7.09%	56.04%	-15.58%	40.46%
Year Ending 31 December 2022	3.65%	-1.79%	1.86%	56.04%	-15.58%	40.46%

Overview

As ever, I am writing this report long after the conclusion of Q1 2023. To be precise it is 2nd June 2023. This is particularly fortunate because the big news, the recommendation by its Board that the assets of the abrdn Japan Investment Trust ('AJIT") be 'rolled over' into NAVF, was only announced in May, though the process to reach that decision began back in March. I discuss this exciting development and its likely consequences below.

In terms of a commentary on our recent performance, and some of the regulatory pressure on Japanese managements driving at least some of it, I thought it would be instructive to include slides 2-9 from our most recent presentation that takes the story to the end of March 2023. Slide 6, which highlights the dramatic effects on the portfolio's performance caused by the continuously weakening yen, is really striking. We have spoken about this before, but it is worth noting that in April and May, the Yen has lost a further 6.3% against sterling. This is at a time when we might have expected the 'loose money' regime of the Japanese Central Bank (BOJ) to start to reverse under the new Governor Ueda. Certainly, continued yen weakness has not helped the somewhat lacklustre performance over the last few weeks, further exacerbated by the Fund's unusually large cash position (see below). As of today, NAV is 143.98, while AUM is £162.73 million.

Perhaps cheekily, I have also included a separate slide 'NAVF: Outperforming the peer group', which was prepared for our discussions with the AJIT Board, but is worth a glance in its own right.

Portfolio Composition

In my last report, I discussed the failed tender offer for T&K Toka launched by NAVF, in conjunction with our co-investors: Michael 1925 and Dalton Investments. I said that we were not finished yet and that our dialogue with the company would continue. I am pleased to say this has been the case, and we currently have a non-disclosure agreement ("NDA") in place, as we continue to explore possible future directions for this business.

The other corporate action that was 'in play' in my last report was the management buyout ("MBO") launched by Mr Nakano, the Chairman of Ihara Science, at our suggestion. I am pleased to say this was concluded successfully and resulted in a 51% gain on our position all of which we tendered into the offer. There will be a two-year moratorium, during which the company's new SPV structure will be controlled by the banks that aided the IPO. At the end of this period, other external shareholders may be allowed to take a position in the new company. We hope to be one of them.

The most obvious effect of both these corporate actions on the portfolio has been the build-up of much larger volumes of cash than normal. At one point, we held nearly £40 million in cash. As followers of the Fund will know, our target companies are typically small cap and, thus, not the most liquid. Therefore, in order to get money to work in the market quickly, we have recently deployed a couple of the largest exchange-traded funds ("ETFs") linked to the Topix index. It is not ideal, and we will switch into existing, and newly selected counters, as quickly as we can. As I write, net cash is around 14.9% of AUM or just over £24 million.

This Golden Week season, as slide 9 suggests, we have sent 13 proposals to portfolio companies' AGMs. To date, we have happily withdrawn 7 of these, as the recipients have initiated some or all of our recommendations. Following our experience with Mitsuboshi Belting last year, this is becoming a regular occurrence.

The portfolio currently consists of 29 counters (27 excluding the ETFs). We have instituted positions in 9 new stocks since the start of the year, and have a fulsome list of reserves ready to go. As slide 5 points out, 50% of companies listed on Prime and 64% of those listed on the Standard market have price-to-book value ratios ("PBRs") below 1.0. No matter how in fashion Japanese investing becomes (see below), we will not be running out of 'suitable cases for treatment' any time soon. During the same period, we have sold out of our holdings in Nihon Denkei, Nihon Kagaki San, Teikoku Electric and Super Tool.

Recent Developments

In the second week of March, we were approached by Shore Capital, broker to AJIT (and, coincidentally, to NAVF as well), as it was facing a continuation vote after a prolonged period of indifferent performance. The Board of AJIT was thinking imaginatively, and wished to be able to make a positive proposal recommending the rolling over of the Fund into another stronger alternative at the forthcoming general meeting. Shore was organising a 'beauty parade' of possible candidates, and asked us if we would like to be considered. Since AJIT is a generalist fund with over 70 small positions in large cap stocks, we felt that recommending a 'merger' with NAVF would be a real leap of faith, but one well worth risking for both parties.

Happily, we won the competition and the terms of the putative deal were published on 18th May and are available on both Funds' websites. The process now moves to both sets of shareholders. Most importantly, AJIT will hold two general meetings in the first and third weeks of August, which are expected to ratify this very exciting action.

What might it mean for NAVF? I am not prone to counting chickens, but for the purposes of this report, it is sensible to look at the most likely consequences should everything go as we anticipate. The first changes to NAVF will occur before the merger: NAVF will issue a prospectus describing the deal, moving from the Specialist Fund Segment of the London Stock Exchange to the Official List, and we will appoint a second broker, Berenberg, who will act as Sponsor for our augmented listing. Moving to the main board is important. First, apart from a few large institutional holders at the top of their shareholder register, most AJIT investors are retail. Second, this is good news for NAVF as in recent months we have been tipped by, amongst others, Questor, Midas, City Wire, Shares, as well as various investment podcasts – a main board listing will make us both more liquid and easier to buy for any retail investor. In fact, we were intending to move up to the main board later this year anyway.

It is impossible to anticipate the absolute amount that will come across to NAVF on closing. We have offered AJIT shareholders a tender for 25% of the Fund's value in cash. It is possible, though very unlikely, that this will not all be taken up. Similarly, we cannot yet know the value of their portfolio on the execution date at the end of August. Were the transaction happening today, their net assets are around £85 million, so after a 25% reduction, we might expect to receive assets in excess of £60 million after expenses. I say assets, as, given the recent strong showing of the Japanese main markets and given our outsized cash position (already discussed), we are negotiating with the Fund's manager to receive the proceeds in specie – in other words, we hope to receive the portfolio in the form of the stocks remaining, once their gearing is repaid. Thus, NAVF will not be 'out of the market', and we can switch these positions into our target portfolio stocks over time.

We are often told by our own institutional investors, that they would like to hold more of us, but we are too small and, because we lack sufficient retail involvement, too illiquid. The AJIT transaction will relieve both of these concerns at once. In addition, the ownership position of several of the Rising Sun Management directors in NAVF will be diluted to levels more in line with market norms. Last, as part of the transaction, the NAVF Board has agreed to expand and welcome one of the AJIT Board members, thus ensuring continued representation of their shareholders' interests.

Outlook

Two interesting things are happening from an investment point of view in Japan right now. Warren Buffet's recent trip there and his redoubling of Berkshire Hathaway's commitment to his chosen names are part of a general revival of foreign interest in the cheapest developed market in the world. Everyone has been waiting for this to happen for a very long time – we have all become accustomed to Japan being perennially cheap. Nevertheless, this time really does feel different. A rising tide will raise all boats, and non-correlated or not, NAVF would expect to benefit from renewed international focus on Japan.

Second, activist investors are beginning to enjoy more frequent successes in their various interventions. The corporate governance reform programme, and, in particular, the changes being demanded to capital values by the TSE, continue to provide a wind at activists' backs. What was a gentle caressing breeze is maybe, just maybe, starting to turn into a genuine gale. I debate the speed of this change in the weather with my more cynical colleagues all the time, but even they acknowledge that it is accelerating and the direction of travel is with us. NAVF, by seizing the AJIT opportunity, and any others that might come our way, will be in the forefront of an activist wave that is only just beginning. With increased size, a fresh prospectus, a main board listing, and two, count'em TWO, brokers, there is a clear path to a further secondary offering in the future. All we need is continued outperformance, so no pressure there…

Paul ffolkes Davis
2nd June 2023